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Editorial Comments

The 1947 Budget

We believe that the most effective way in which this journal can comment on the budget proposals, made by the Minister of Finance on April 29, 1947 with particular regard to income and excess profits taxes, is to suggest that all our readers review the article on Post-War Taxation written by Walter L. Gordon and published in our December 1944 issue. Reductions in personal taxes incorporated in the 1945 and 1946 budgets should be taken into account when making a comparison. Mr. Gordon's views appear to have received a most sympathetic hearing.

Income Tax Rulings

On a later page there is reproduced "Directive Number 8" of the Department of National Revenue, Taxation Division, on the subject "Assessments—Deductions — Membership fees." The word "directive" apparently takes the place of the discouraged word "ruling".

This directive merely confirms the view of the Department taken until the Bond and Rutherford Exchequer Court Decisions (reported in our January 1947 issue) rather shook its confidence. Just how the Department can reaffirm its view after two adverse decisions of the Exchequer Court is somewhat of a mystery. Is it going to make ex-

ceptions to the directive in favour of Messrs. Bond and Rutherford and others in an exactly similar position?

The point we really want to make, however, is that here we have a directive, clearly marked "for public circulation", which proceeds to lecture a taxpayer on how he should feel about taxation. It closes by speaking of a tax concession. In all our reading of the law of taxation, we have never heard of an administrative tax concession. The judgments referred to above clearly stated that the taxpayers were entitled to relief as a matter of law and we have had it drilled into us almost *ad nauseum* that a tax statute must be rigidly construed. For the administrative officers to say that a taxpayer is not entitled to expect a government contribution by way of a tax concession is a strange state of affairs. We are surprised that an admission is made that the word "concession" was ever known by the administrative mind.

Then we have the soft-soaped suggestion by flattery—"any well-conducted organization which wishes to have members of its staff belong to such associations will readily arrange an additional membership subscription." This sentence is obviously introduced to assist an employee to prevail upon his employer to absorb an expense which the latter may feel he has already provided for in the salary paid. The suggestion that the employee considers a personal payment of fees worthwhile from the standpoint of his future advancement is not fair as it may well be that an understood part of the employment arrangement is that he will keep up his interest in the particular association concerned.

We also take it from the wording of the directive that there is some distinction to be made between a well-conducted employer and a not-so-well-conducted employer. This places before the employee a rather difficult field for investigation.

We begin to regret the kind words of the first editorial in our April 1947 issue, and we quote from an article "Can we Reform our Bureaucrats?" by Hugh Morrow in the Saturday Evening Post of May 10, 1947—"Directive — a word which in itself is an equivocation meaning anything from a 'pretty please' to an Olympian demand".

Unfair Presentations

Some months ago we commented on the inclination of newspapers to colour facts reported in news columns and to distort these facts to meet the political leanings of the proprietors. This failing is not confined to news reporters only as we learn by reading Hansard. During April, Mr. M. J. Coldwell, leader of the CCF party, undertook a discussion of the "abnormal profits" currently being earned by corporations and compared the profits of several for their 1946 period against those for the 1945 period. He was careful to leave dollars and cents out of the discussion and resolved the whole business to a matter of percentages. For example, the net profits of a knitting company for 1946 were 309% higher than in 1945; a building products company earned profits in 1946 286% higher than in 1945 and so on. The fallacy in this manner of comparison is obvious if one uses as an example a corporation which earned $1,000.00 in 1945 and $10,000.00 in 1946. Without taking into account the capital of the corporation or its turnover, it could be said that its profits were 900% higher in 1946 than in 1945. We do not guarantee this calculation as we are not quite sure just what is meant by a percentage "X" times higher in one year than another. Just what Mr. Coldwell would have done if he had compared the profits of a company earning a loss one year and a profit the next, we cannot imagine.

This journal has no political interest and does not take sides in the game of politics. We do protest, however, when one side or the other plays the game in a manner which we consider unfair by making statements so distorted that one finds them to be quite without real meaning. The statements, being without real meaning, can have no purpose other than to attract public attention, and to leave with listeners or readers a completely false impression. The obvious answer to such statements does not receive the same consideration as the original presentation.

Distortion of fact in speeches by politicians is not unusual and is indulged in by all parties. Even if it accomplishes nothing in the long run, it cheapens, not only the debater, but the whole parliamentary process. In our view, it is a tactic wholly without justification and quite outside the manner by which a democratic state should conduct its affairs.

Income Tax Appeals

We have been interested to note in the Federal Accountant, official journal of the Federal Institute of Accountants (Australia), that the Commonwealth Taxation Board of Review publishes from time to time summaries of its decisions on taxation matters. The eleventh volume is now available. "As the activities of the Board embrace a far greater number of taxation cases than come before the courts", says the Federal Accountant, "volume 11, like its predecessors, should be of very considerable interest and assistance to business men, accountants and taxation specialists." We look forward to a similar publication in Canada.

ANNUAL MEETING

We have received word from the Committee on Arrangements that plans for the annual meeting are progressing favourably. Taking advantage of train schedules, the program is being arranged to provide three days for members, in addition to the Council and Committee meetings on the Monday and Tuesday. Dates for the meeting are September 8th to 12th and the convention headquarters will be the Hotel Vancouver. The Committee on Arrangements urges you to arrange for your accommodation as soon as possible.

Inventories and Their Treatment

By Clem L. King C.A.

**Secretary and Director of Research,
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THE problems connected with inventories probably require more time and thought on the part of accountants than any other single item appearing on the Balance Sheets and Income Statements reviewed by them from time to time. This is natural, however, since every variation in the inventory is reflected in both the Balance Sheet and the Income Statement.

When the accountant uses the term "inventory", he means the stock-in-trade of a concern; the balance of its "working assets", that is those assets with which it deals or trades or the materials used in its manufacturing processes; in short, the assets which it expects will do the job of producing profits. The items making up the inventory may be goods ready to be sold in their present state, those upon which a certain amount of processing must be done before they are ready for sale or those which are in a raw state and upon which no processing has been done to put them into the condition in which they can be sold. The fixed assets of one concern may be the assets which go to make up the inventory of another concern.

The basis of valuation for the inventory will depend to some degree upon the purpose for which the valuation is being made. In the winding-up of a business, the probable realizable value will be the figure sought for. In the preparation of a balance sheet for short term credit purposes, the worth of the inventory as a security, or its probable value to a going concern is the figure desired. From the standpoint of the Income Statement, the valuation placed upon the inventory should be that figure, which so far as the gross profit is concerned, provides the truest statement of the income for the period.

For the purpose of this discussion the assumption will be made, as is ordinarily the case in actual practice, that valuation and treatments accorded inventories are those applicable to a "going concern". While the future success or

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An address given to the Chartered Accountants Students' Society of the Province of Quebec on March 25, 1947.

failure of a business cannot be forecast, on the basis of past experience, continued operation can be anticipated. Therefore, on the basis of this assumption, one of the fundamental concepts is that inventories shall be regarded as being a collection of costs, adhering to the items under consideration, which are applicable to the future operations of the business. To put it in other terms, the income statement is to be regarded as an attempt to measure at relatively short intervals the revenue for the interval and the costs incurred in securing that revenue.

On the other hand there is the viewpoint which has developed over the years in respect of the valuation of items, as a result of regarding the Balance Sheet as the only significant statement. The average entrepreneur, if such a person exists today in this world where it is sometimes fashionable to give the word "profit" a connotation of "evil", regards his business through roseate lenses. He has a naturally understandable tendency to overestimate his assets and underestimate his liabilities. (This last statement is predicated on the assumption that the impact of taxation has no effect upon the accounting treatment accorded business transactions.) The creditor, or potential creditor, on the other hand has a somewhat cynical viewpoint in respect of these items. The accountant has developed what is often termed a "conservative" viewpoint in respect of asset valuations. Quite naturally he has never wanted to be in the position where he would be accused of certifying a statement as presenting a proper picture when in fact the assets were overstated or the liabilities understated.

Another fundamental concept of accounting for the income of any fiscal period is that all known expenses must be provided for, as well as known losses, and that income must not be anticipated.

In the economic society in which business in this country is conducted, the price (in dollars) of the various items that are purchased by a business and which make up its inventory will vary from time to time. Following the rule that costs must be matched with revenue, the literal interpretation, in the case of determining the cost of goods sold, would require that this figure be made up of the cost of each individual item sold. Except in few instances, this is physically impracticable, because of the volume of the

transactions that would have to be so accounted for. However this literal interpretation conflicts with the dictum that all known losses or expenses must be taken into account and that profits must not be anticipated. Under the foregoing procedure, the costs of goods sold figure would be made up of the actual cost of the individual items sold, and the inventory at the end of the period would be valued at cost. In the meantime however, business conditions may have changed so materially that the merchandise would not realize even the price originally paid for it. Under such circumstances few accountants would submit that the net income for the year, using the cost of goods sold figure as determined previously, would be the correct figure, nor could the valuation appearing on the balance sheet be regarded as being correct under such circumstances. In order to reconcile these two concepts, the rule "cost or market" was evolved.

It is easy to say that an inventory shall be valued at its cost or market value, whichever is the lower, but when it comes to the actual application of the rule it is found to be a nebulous basis upon which to work and subject to an almost unlimited variety of interpretation. In the first place the word "cost" has to be defined. The generally accepted interpretation of the term is that the cost of an article is the sum total of the charges incurred in laying the item down in the firm's place of business in such a condition that it is available for resale or its intended use without further expenditure being made upon it. This is fine so far as it goes, the only difficulty is that when it comes to the practical application of this definition to the items that have been sold during the fiscal period and to the items still remaining in the inventory, there are a number of like items in the inventory, and in the costs of goods sold figure, which have been purchased at varying costs during the period. Not being able to identify the individual items with the varying costs, some reasonable means of securing the cost figure which will be used for valuation purposes must be secured. In the cases where perpetual inventories are not maintained, the figure to be arrived at is the cost for valuation purposes at the end of the fiscal period. When this cost is applied to the items on hand, the cost of goods sold figure is automatically forced. Where perpetual inventories are maintained, the cost figures are

applied during the period to the items removed for sale, and the cost of goods sold figure and the cost of the inventory on hand are automatically determined.

In addition to this difficulty, there is a difference of opinion as to what figure is to be regarded as the invoice cost of the items. The most commonly accepted practice at the present is to record invoices at their gross figure, and treat the discount for prompt payment as financial income. It is difficult to justify this practice, since it is seldom that the purchaser expects to pay the gross price and rarely that the vendor expects to collect it. If the management of a business is reasonably competent, it will make certain that funds are available for this purpose and it will be inclined to question any discounts that have been overlooked. A distinct advantage of recording invoices at their net figure is that discounts which have been overlooked are brought to notice.

The other problems are in the nature of practical difficulties, and judgment will indicate the amount of effort which should be expended in determining the fair allocations of shipping charges and like items. In respect of goods in process, the most difficult question to determine is the amount of overhead or factory burden to be applied to the unfinished goods on hand. The most logical approach is to provide for the application of that amount of expense normally charged to a like quantity of production at the rates prevailing during the immediately preceding month, provided that the amount of stock on hand is not significantly in excess of one month's production.

Where a standard cost system is maintained, the inventories should be valued at the standard cost plus or minus the variations in actual cost from the standard. This is in conformity with the principle that all transactions should record what actually occurred, not what might have occurred had circumstances been more or less favourable.

Coming back to the problem of the valuation to be accorded the inventory on hand at the end of the fiscal period, in other words, to the figure that will be used in the income determination and the balance sheet, there are, fundamentally, three bases of valuation. The first is the figure at which the items are presently recorded in the books, that is, actual cost. The second is market, which is ordinarily regarded as being the replacement cost, if the materials

were to be purchased through the usual channels, in the usual quantities under usual conditions. The third is a price based upon the apparent probable selling price. In most instances on a rising market, there is no question as to the basis of valuation to be accorded the inventory since cost is not more than market or the figure based upon selling price. When the cost figure is above market or the third basis there is ground for different treatment, varying according to the circumstances and the views of the individuals concerned.

It was out of the attempt to meet this problem that the different methods of costing were derived, the most prominent of which are Last In First Out, First In First Out, Average Cost, Base Stock and the Retail Inventory method.

Little need be said in respect of the Average Cost method, except to point out that the cost figure so determined is either more or less than the costs as determined from the most recent purchases according to whether the business is operating in a period of falling or rising prices. The average is computed on the assumption that materials purchased first are disposed of first, and it must be recalculated with each purchase.

The First In First Out method also operates on the assumption that materials purchased first are always disposed of first. As in the Average Cost method, this assumption coincides with merchandising practice. A further advantage is that the maintenance of the records is fairly simple since there is no necessity to recalculate the average each time a new lot of materials is purchased.

Some organizations have objected strenuously to valuing inventories on the basis of cost, be it higher or lower than market, because the selling price of their commodities is extremely sensitive to variations in the price of the raw material. The American Petroleum Institute has adopted the LIFO method of pricing inventories. Supporters of this policy are usually those who take the stand that the Income Statement is the all important statement, and that the prime purpose of accounting is income measurement. Under this method it is quite true that the figure that finds its way into the cost of goods sold total is made up of the prices prevailing at the dates nearest to that on which the material was sold. However, the valuation of the inventory will ordinarily bear little or no relationship to current

market prices, selling prices, or to the original cost of the physical items going to make up the inventory. Another argument raised in its favour is that the use of this method levels off the peaks and valleys which appear on the concern's income record. Such levelling is all to the good if it merely results in introducing a degree of artificial stability to an otherwise unstable or widely varying situation, then it is to be condemned. It would be interesting to determine just what effect the impact of taxation has had on the promotion of this method of costing inventories.

In its actual operation the LIFO method brings about a result somewhat similar to the Base Stock method of valuation, in that, unless the inventory drops below a certain base level, it will continue to be valued at the same rate. Both the LIFO method and the Base Stock method encounter severe criticism when replacement costs fall substantially below recorded values. Great care has to be taken in timing the starting point of these systems in order to ensure that the valuation figures used will be as close to normal as possible.

The Retail Inventory system is primarily a device utilized in the retail trade for the purposes of inventory control. Records are maintained on the basis of selling prices, which can be reconverted to cost figures at the end of a fiscal period. The problem of inventory valuation for Income Statement and Balance Sheet purposes still remains.

The foregoing methods are used in the accumulation of the cost of goods sold figure during the fiscal period, but only in the LIFO and Base Stock methods, (and in the latter only when the stock on hand does not exceed the base stock) is the unadjusted figure as recorded on the books used. In the other cases if the market or replacement price is less than cost, consideration must be given to the basis upon which the inventory is to be valued. The generally accepted stand at the moment is that known expenses and/or losses must be taken into account and this of course includes losses as the result of declining market prices of the goods included in inventories. The practical difficulty, however, is in the determination of the level, lower than cost, which should be used in such circumstances.

The stand that inventories must always be valued on the basis of cost or market, whichever is the lower, is often supported by the argument that it is a conservative policy,

and therefore to be recommended. Such a policy of conservatism in respect of the period under review, if not founded upon reasoned judgment, will have the opposite result in the following period. If costs are unduly increased in one period, the practical result is that profits are merely deferred to later periods, producing an undue inflation of the later income figures. Since accounting attempts to present the fairest and truest picture possible, such practices cannot be condoned. Fundamentally, the problems of inventory valuation are attempts to state the income for the period as accurately as possible, taking into account past operations and future prospects, and having consideration for the position to be shown by the Balance Sheet.

If the concern has firm commitments, which it expects will be honoured, for the sale of a portion or all of the items in the inventory, and the selling price is based upon the expectation of a normal return in relation to the cost of the inventory, then there is no necessity to reduce the valuation of the items referred to below cost. To do so would reduce the profit of the period under review unnecessarily and result in an overstatement of the income of the following period or periods.

If the markets for the products of the concern is such that a reduction in costs of the inventories is not followed by a corresponding reduction in sales prices, or, to put it in other terms, if the situation is such that in spite of the drop in replacement costs the normal profit margin would probably be attained, then there would not appear to be any valid argument for reducing the profits of the current period in rigid adherence to the rule, merely to produce an inflated profit for the following period.

If, however, the selling price reacts fairly sensitively to variations in the cost price of the inventory material, it is self-evident that the selling price in the subsequent period will be reduced. Assuming we have an article costing $100 which normally sells for $120. The replacement cost has dropped to $90 and the probable selling price drops to $110. The cost to sell is $12 per unit, the usual profit margin—$5 per unit. Under these circumstances a choice must be made between the following bases:

Cost	$100
Selling price less cost to sell	98

Selling price less normal profit	93
Replacement cost (market)	90

If the stand is taken that the current period should absorb all expenses and losses incurred or determinable so that the future period will have a clear start and be in a position to earn a normal profit, then the value for inventory purposes need not be more than $93. Even though the replacement cost is $90 or something less than the price at which the article must be sold to cover the normal profit margin and the cost to sell, it is difficult to find any justification for reducing the value in this case below $93.

The rule now becomes "cost or market, whichever is the lower", taking into account the costs of selling and the normal profit margins. This situation applies also to instances in which the items must be devalued because the material is obsolete or damaged.

For the purpose of presenting useful statements, it is advisable to segregate the amount of the write-offs in respect of shop-worn merchandise and market losses caused by ill-advised purchasing or defective sales activities from the cost-of-goods sold figure and to charge them to separate accounts or to accounts more closely approximating their nature.

The next problem to be solved is the method of presentation of the adjustment made in the inventory valuation. In ordinary circumstances the cost of goods sold figure is a combination of the cost of materials sold during the year, as determined by the method of costing in use, and any price adjustment necessitated by dropping market prices. However, it would be much better if the statements were compiled in such a manner that the reduction of profits, because of the recognition of a necessary downward valuation of the inventory, was shown as a separate figure. In this manner those reading the statements would be in a better position to judge the amount of reduction in profits brought about by conditions beyond the control of the management of the concern. From the standpoint of the management, it is only by such an analysis that it is able to compare the results of various years in an intelligent manner.

In the determination of the value to be placed upon the inventory, there is a difference of opinion as to whether the lower of cost or market, or the figure based upon the

selling price, should be applied to the inventory as a whole, to individual items in the inventory or to the various groups into which the inventory is naturally classified. The most practical method is to determine the lower figure by groups or classes of items. While the process of valuation by individual items would result in a lower overall figure for the inventory, it is not necessarily true that the more conservative approach is necessarily the better one, and further, since the process is to a certain extent a reasoned "guesstimate", there is no necessity of becoming immersed in detail. If you refer to the March issue of The Canadian Chartered Accountant you will notice a comment in the editorials in respect of a contingency reserve of $10,389.30. Not only is such apparent accuracy ridiculous, but it also tends to mislead the reader.

The recommendations of the Institute of Chartered Accountants of England and Wales in respect of Inventory valuation are briefly as follows:

(a) Inventories should be valued at the lower of cost or market
(b) Cost should be calculated on such a basis as will give a fair presentation of the trend of results.
(c) Market value is to be calculated as selling price less estimated expenses of sale.
(d) In valuing inventories for the purposes of determining the lower of cost or market, the lower of the aggregate cost or aggregate market value may be used, but they allow the lower of the individual items or groups.

"Whatever basis is adopted for ascertaining cost or calculating market value, it should be such as will not distort the view of the real trend of trading results and should be applied consistently regardless of the amount of profits available or losses sustained. Any reduction in stock values which exceeds the provisions embodied in the above recommendations is a reserve and should be shown as such in the accounts."

The American viewpoint may be summarized in the following terms:

(a) The prime objective of inventory accounting is the matching of costs against revenues.
(b) The term market is to mean replacement cost.
(c) The general attitude in respect of determining the valuations to be placed on the inventory is to determine the lower of the cost or market figure on the inventory as a whole, or on its natural groupings, rather than on individual items.
(d) The amount of the charge resulting from the reduction of the inventory value to something less than cost should be shown as a separate figure on the statements.

The position where the figure for inventory is being written down as a result of market declines should not be confused with the position where the management is at-

tempting to provide for losses which will result from still further declining prices. In the latter case, such provision should be treated as a "Reserve Against Future Inventory Losses." This is more properly a segregation of profits and should be shown as a separate item either in the Income Statement or Surplus Statement, but in no case should it be included in the figure for cost of goods sold.

The important factor in the problem of inventory valuation is that, whatever method is used, it should be adopted only after due consideration of the peculiarities and requirements of the particular business. While there is no question but what there are occasions when the valuation given to the inventory must be reduced below cost, care should be taken that the treatment accorded is not so "conservative" that the end result is a distortion of the income of the year. And last but not least, whatever course is followed, it should be followed consistently, and any deviation therefrom should be clearly set out.

Audits

Early in the development of the profession, public accountants recognized that the only reliable criterion for judging the correctness of the accounting treatment of transactions was verifiable objective evidence. This viewpoint has gained in stature as the profession has matured. In their book "Corporate Accounting Standards", Littleton and Patton emphasize this point as follows:

> "This emphasis upon objective evidence has never been weakened; in fact it has become stronger as complex business activities have increased and as business management and financial investment have drawn further apart. Verifiable, objective evidence has therefore become an important element in accounting and a necessary adjunct to the proper execution of the accounting function of supplying dependable information."

However, following the judgment of the Kingston Cotton Mill Company Limited in 1896, auditors took the stand that their responsibility, so far as the inventory was concerned, was to all practical purposes provided for if they secured a certificate as to its accuracy from a responsible official of the concern. Dicksee—16th Edition—states that the original stock sheets, signed by the stocktaker, calculation checker and manager must be examined and major extensions and additions checked; the auditor should make an intelligent scrutiny of the stock sheets—comparing them with previous sheets and in cases where it is feasible mak-

ing certain checks against recorded purchases and sales, and, in addition, a close scrutiny should be made of recent purchases, with a view to the discovery of any errors or omissions from the stock sheets.

In addition to the foregoing, the auditor usually applies such other tests as are available, such as the "gross profit test" and the reasonableness of purchases and inventories having regard to their usual relationship to the volume of sales.

The audit procedure is that the other items on the balance sheet are subjected to close scrutiny and objective verification as to their accuracy and reasonableness, but the inventory, usually a most significant item, particularly in the current asset section, is accepted upon a certificate of the management. So far as the Profit and Loss statement is concerned, the same attitude prevails. Other items are subjected to close scrutiny, either in detailed checking or by testing of the operations of the system of internal control, whereas that portion of the cost of goods sold figure, which is determined by the valuation placed upon the inventory, is accepted as stated.

American practice developed along similar lines until more recent years, although there has always been a greater tendency in the United States to attempt an independent verification of the inventory figure. In 1939, a case involving falsification of inventories by the effective owner of a concern brought about a full scale review of the question. The situation in the U.S. is rather unique in that the Securities and Exchange Commission has been given wide powers in connection with the manner of presentation and scope of verification of the statements filed with them, and this has influenced auditing procedures. Since this field covers all major companies in the U.S., it naturally brings under scrutiny of the S. E. C., the statements reported on by a large number of accounting firms in the States. As a result of the discussions in following this case, the American Institute of Accountants brought out their Statement No. 1 on Auditing Procedure, part of which reads as follows:

> "Added steps may well be taken to give greater assurance with regard to inventories. The extent of such additional procedures will necessarily vary with the circumstances, because the independent auditor is justified in giving consideration to the effectiveness

of the internal check and control as applied not only to book records, but also to the procedure of taking physical inventories, but, however extensive these may be, the training and experience of an independent certified public accountant do not qualify him as a general appraiser, valuer, or expert in materials. The public should understand that, while he can in his capacity as an auditor undertake additional procedures as to inventories, such procedures do not invest his opinion with a degree of authority which he does not claim for it or impose upon him a measure of responsibility which the nature of his work does not justify. Such procedures are only for the purpose of satisfying himself as to the credibility of the representations of the management regarding quantity and condition.

Taken in consideration with the foregoing discussion of auditing procedures, the following recommendations are made concerning inventories:

(A) That hereafter, where the independent certified public accountant intends to report over his signature on the financial statements of a concern in which inventories are a material factor, it should be generally accepted auditing procedure that, in addition to making auditing tests and checks of the inventory accounts and records, he shall, wherever practicable and reasonable, be present, either in person or by his representatives, at the inventory-taking and by suitable observation and inquiry satisfy himself as to the effectiveness of the methods of inventory-taking and as to the measure of reliance which may be placed upon the client's representations as to inventories and upon the records thereof. In this connection the independent certified public accountant may require physical tests of inventories to be made under his observation.

In cases where the inventory is determined solely by means of a physical inventory at the end of the accounting period (or at a date prior or subsequent thereto but within a reasonable time thereof with adequate records supporting the interim changes), it will ordinarily be necessary for the foregoing procedures to be followed at that time.

In cases where the concern maintains well kept and controlled perpetual inventory records supported by (1) a complete physical inventory at a date not coincident with the balance-sheet date, or (2) physical inventories of individual items taken from time to time so that the quantity of each item on hand is compared with the inventory record for that item at least once in each year, it will be satisfactory to undertake the procedure outlined at any interim date or dates selected by the auditor, his purpose being to satisfy himself as to the credibility of the perpetual-inventory records and whether they may be relied upon to support the inventory totals as shown on the balance-sheet.

(B) That hereafter, in the case of inventories which in the ordinary course of business are in the hands of public warehouses or other outside custodians, direct confirmation in writing from such custodians is acceptable procedure; except that, where the amount involved represents a significant proportion of the current assets or of the total assets of a concern, the independent certified public accountant shall make supplementary inquiries.

It should be clearly understood that, in undertaking these auditing procedures regarding inventories, the independent certified public accountant does so for the purpose of satisfying himself as to the credibility of the representations of the management

regarding quantity and condition and does not hold himself out as a general appraiser, valuer, or expert in materials."

At the 1940 annual meeting of the American Institute of Accountants Mr. Prior Sinclair of New York, a member of the A. I. of A., had this to say in connection with the experiences of accountants in auditing under the new recommendations:

"Review of the experiences of numerous accountants with extensions of auditing procedure with respect to inventories indicates:

1. Generally in only relatively few cases involving very valuable materials and under circumstances where substitution is not difficult need the accountant, due to his lack of qualifications as a general appraiser, valuer, or expert in materials, refrain from expressing an opinion as to the credibility of the representations of the management regarding quantity and condition.
2. In those industries in which it is customary to take physical inventories, no instances have been observed where it is not practicable and reasonable to be present at the inventory taking and by suitable observation and inquiry formulate an opinion as to the effectiveness of the methods of inventory taking, although it may not always be feasible to supplement such observation and inquiry by tests of quantities. The extent of the accountant's contact with the inventory will be governed by the effectiveness of the internal check as applied to the taking of physical inventory.
3. In those industries in which the inventory amounts are customarily determined from book records adjusted to facts upon their determination, it is usually feasible for the accountant to examine into the effectiveness of the methods which provide for current adjustment, to make some corroborative tests and in conjunction with related operating factors and pertinent inquiry to formulate an opinion as to the general integrity of the inventory records.

In closing, it may be interesting to refer to some of the comments which were received from several accountants as to the effect upon client relationships and other matters.

The beneficial effect on client's employees when they knew their work was to be checked by outsiders was considered important and was felt to have resulted in more accurate physical inventories.

Some accountants overcame the problem of distribution of staff by shifting the inventory-taking date away from the end of the fiscal year and by establishing from the records the effect of interim transactions upon the inventory. The results were reported as satisfactory and the comment by the client was favorable.

In some instances visiting the clients about a month prior to time of inventory taking and reviewing the inventory instructions resulted in uniformity of inventory methods in warehouses and factories throughout the country, and an appreciation by the clients of the benefits derived.

As a result of quantity tests some instances were uncovered of a deliberate falsification of records by branch managers.

In another case errors in physical inventory brought about a rearrangement of stock rooms to simplify taking of future inventories and to provide the management with more reliable interim information.

> The impression which I receive from the reported experiences of accountants during the past year is that, whereas the extensions to auditing procedure were instituted primarily in response to public demand for confirmation by some independent agency of management's representations as to inventory quantities, the greatest benefit from the new procedures will accrue to management itself. Management realizes that extension of the certified accountant's services to physical contact with the inventories results in more efficient inventory methods and a greater dependability in the reports of departments and branches.
>
> In conclusion, from experience thus far it is evident that the necessary additional fees for such work will be more than justified by the value to clients of the services rendered."

In my opinion, Canadian practice in respect of inventories is at the cross-roads, and a definite stand will have to be taken soon. There would seem to be no valid practical reason why public accountants should not undertake the responsibility for forming an independent opinion as to the existence of the inventory and the accuracy and validity of the management's statements in respect thereto, instead of resting on the, in my mind, doubtful legal protection of a judgment delivered 50 years ago, when the complexity of business conditions was in no way comparable to that prevailing today. In addition, the general concept of the moral responsibility of business to employees, investors and the public generally is undergoing a radical change, and if the public accountant does not live up to the responsibilities expected of him, even though they are not prescribed and exist in a rather nebulous form in the minds of the public, he will be subjected to severe criticism and possibly governmental regulation.

In the Kingston Cotton Mill Case Lord Justice Lindley stated in his judgment:—

> "It is no part of the auditor's duty to *take stock*. No one contends that it is. He must rely on other people for details of the stock-in-trade in hand. In the case of a cotton mill he must rely on some skilled person for the materials necessary to enable him to enter the stock-in-trade at its proper value in the Balance Sheet."

Lord J. Lopes stated:—

> "It is the duty of an auditor to bring to bear on the work he has to perform that skill, care, and caution which a reasonable competent, careful, and cautious auditor would use. What is reasonable skill, care and caution must depend on the particular circumstances of the case."

In the London Oil Storage Case in 1904—The Lord Chief Justice stated in his judgment:—

> "While Mr. Hasluck has by the exercise of due and reasonable care to see that all the officials of the company are doing their

> duty properly in so far as the accounts are concerned, he is not bound to assume when he comes to do this duty that he is dealing with fraudulent and dishonest people" . . . further . . . "Now you must not think that those words, 'as shown by the books of the Company' excuse the Auditor from making proper inquiries into any particular entry in the books. The question always becomes, what, under the circumstances of the case, is a proper inquiry to make in every particular case." . . . further . . . "It cannot be disputed that when an auditor returns to the shareholders an entry of cash in hand he must have taken reasonable steps to ascertain that the cash was in hand."

While the foregoing excerpts eliminate from the auditor's sphere of responsibility the necessity of *taking* stock, they definitely place on his shoulders the responsibility of using such reasonable care as would be exercised by a reasonably competent auditor, according to the particular circumstances of the case.

If the accounting profession is to maintain the high position that it has made for itself as a result of the skill and integrity of the men who founded the profession and brought it to its present level, every member will have to be on constant guard to see that the standards which the profession sets for itself are considerably higher than those which any other body, business or governmental, would set for it. Every principle, and its application, must be the subject of continuous critical scrutiny to ensure that we do not become complacent with our accomplishments, and as a result lay ourselves open to the criticism that we no longer meet the needs of business men, investors and the public generally.

Recruitment and Selection of Staff Accounting Personnel

Report on scoring of Strong Interest Blanks received from members of The Dominion Association of Chartered Accountants and tabulated by the American Institute of Accountants "Committee on Selection of Personnel".

MEMBERS of your Association sent in over 1,000 blanks of which 640 blanks including 437 juniors, 72 senior accountants and 131 partners were received in time to be scored for this report. These blanks were scored at Columbia University by the use of the same special tabulating equipment that was used in scoring the blanks obtained from members of our Institute. The remaining part of this paper was dictated by Dr. Arthur E. Traxler, Assistant Director of our research project and has been reviewed by Dr. Ben Wood, our research director.

The materials which have been distributed show the kinds of analysis which our research staff made on the basis of the results. Exhibit 1 is the form on which the reports were made to the various Canadian firms and thus it is one with which many of you are already acquainted. On this exhibit the 27 occupations are arranged in order of the size of the average standard scores made by accountants in the United States. The irregular line running rather diagonally across the chart, connects the average scores in the different occupations. As you will see, accountant is first, C.P.A. is second and so forth, going down to psychologist as the 27th occupation.

A word of explanation concerning the differences between the scales for accountant and C.P.A. may be desirable. In brief, Strong's accountant's scale is based on the responses of accountants employed in individual business firms, whereas his C.P.A. scale is based on the responses

Editor's Note: In our November 1946 issue, we printed Mr. Warren W. Nissley's address to the Annual Meeting of the Association held in Montreal in September 1946. As explained in "Editorial Comment" we did not at that time publish that part of his paper dealing with the Strong Interest Blanks received from the Association. It is now reproduced with the exhibits which accompanied it and it should be read having in mind Mr. Nissley's previous discussion of this subject.

of men certified as public accountants in the States of New York and California who have been previously referred to.

A question may properly be raised concerning the reason for higher average scores, both for the United States and for the Canadian group, on Strong's accountant's scale than on his C.P.A. scale, in view of the fact that the averages of both groups are based on the scores of men engaged in public accounting. A partial explanation for this seeming inconsistency is that many of the men in both groups whose scores were used to obtain the average scores were junior accountants and not all of them will succeed in becoming certified public accountants and that others will eventually leave professional practice to accept an accounting position with a particular corporation. If one compares the average scores for the partners with those for the juniors, he will see that whereas the juniors are considerably higher on the accountant's scale than on the C.P.A. scale, both the United States and Canadian partners scored higher on the C.P.A. scale than on the accountant's scale. This fact is brought out by the graphs on the second and fourth exhibits. Except for this significant difference and differences of a few points on some of the other scales, there is a general similarity between the profiles for the partners and the juniors.

It will no doubt be of interest to compare the average scores of the 640 public accountants in Canada who took the Strong blank with the scores of the 1,000 public accountants in the United States. The medians for the two groups are shown on Exhibit 3. It is apparent that the public accountants in the two countries are very similar in average interests as measured by the Strong blank. It is especially interesting to note that the differences between the two groups on the accountant scale and the C.P.A. scale are in each case not more than one point.

The median lines for the three levels of Canadian public accountants, partners, seniors and juniors are shown on Exhibit 4. These lines are in general similar to one another, but there are some interesting differences, particularly on the accountant and C.P.A. scales. On the accountant's scale, the seniors are highest, the juniors next and the partners lowest, but on the C.P.A. scale, the juniors and seniors have almost identical average scores, whereas

the partners are several points higher than these two groups. A somewhat similar relationship was found in the States.

Exhibits 5, 6 and 7 show the average scores of the three levels of accountants in the two countries. As you will see, the two lines for the junior accountants are very much alike and this statement is also true for the senior accountants and the partners in the two countries. One conclusion indicated by these results is that the Strong blank should be approximately as reliable and valid when used with public accountants in Canada as when used with public accountants in the States.

It should of course be born in mind that the lines shown on the graphs just discussed represent average scores. It is desirable to point out that for each level of accountants on each scale there are wide differences among individuals. This fact is shown clearly by the table on Exhibit 8. On the C.P.A. scale, for example, it will be noted that although, as already observed, the average for the partners falls within the A rating, a few partners who have been successful in their profession have ratings of B—, C+ or C. Similarly, for the junior accountants, we note that the individuals are distributed from a high A rating to a rating below the C level. In the interpretation of the results for an individual, one should be aware of the fact that while a high score in the occupation of ones choice is very desirable and suggests the probability of success in that occupation (providing he has the other necessary qualities) a low score does not necessarily preclude success in the occupation. While such cases are rare, every study so far made reveals a few successful public accountants who receive low scores on the accounting and C.P.A. scales. Such discrepancies are probably due, in part, to the inherent unreliability of any thirty minute test, and in part to the fact that certain individuals whose interests do not conform to those of the profession in general, possess other qualities which offset their deviation from the professional interest norm.

Exhibits 9, 10 and 11 show the interest profiles of three public accountants in Canada. These are the actual scores of the three men although their names have been changed.

The first man, George Olson, has an interest profile

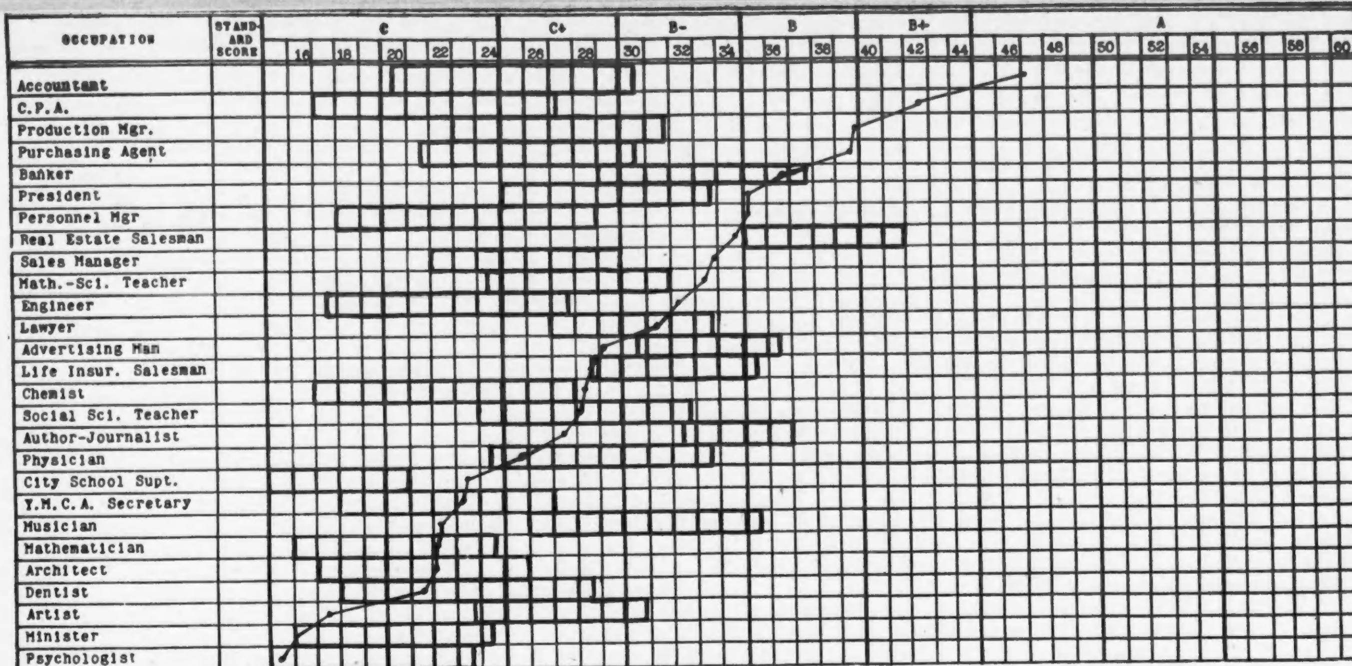
which bears only a general similarity to the median line for 1,000 public accountants but the general slope of the line is accentuated in a favourable direction. You will note that he is extremely high on the accounting scale and that he also has an A rating on the C.P.A. scale, although the score is lower than the one for accounting. He also has A ratings for purchasing agent and for personnel manager, both of which are positively related in score to the field of accounting. At the bottom of Olson's profile there are three exceptionally low scores, those for mathematician, architect and artist. It may be desirable to state at this point that the mathematician scale is based on the interest of 181 persons, including college professors, who are designated as professional mathematicians in "American Men of Science" and not on the interests of a group who may have the numerical skills desirable for an accountant.

The scores of John Baker illustrate the profile of an individual whose results are on the whole in close agreement with the median profile.

The sheet for Frank Masters brings out a sharp contrast between the interests of an individual and the median interests of public accountants. This man has a score of C+ on the accountant's scale and an extremely low score, below C, on the C.P.A. scale. Apparently his interests agree with those of engineers, for he has an A rating on this occupation, and he also appears to have, to a considerable degree, the interests of chemists and dentists. On the basis of the Strong test, one would not advise this young man to enter public accounting but would direct him towards one of the occupations in which he has high scores. It should, however, be emphasized that in selection and placement, it is highly desirable to make use of the results of general ability tests and achievement tests to supplement the evidence obtained with the interest blank.

We appreciate the co-operation of your Association in submitting these blanks. We hope that the foregoing report, which I am sure that Dr. Wood would be glad to supplement if you so desire, will be of value to you.

EXHIBIT 1



Your occupational interests are recorded under the heading "standard score" and opposite the appropriate occupations.

The higher a score to the right of the shaded area the greater the certainty that one has the interests characteristic of that occupation. The lower the score to the left of the shaded area the greater the certainty that one does not have the interests of the occupation. Scores falling within the shaded area are indeterminate: they help sometimes to show, along with other scores, the general trend of one's interests in an occupational group. But generally they can be ignored.

Standard scores of 45 and above are rated A, meaning one has the interests characteristic of men successfully engaged in the occupation. Ratings of B+, B, and B— also indicate possession of the interests characterizing men in those occupations, but at the same time they represent less and less assurance that the classification is correct.

About 15 per cent of men known to be successful rate B+; about 9 per cent rate B; about 4 per cent, B—; and about 2 per cent C+ and C. Occasionally a successful man rates below C+. On the other hand, many successful men rate B—, B, and B+, and a few rate A in occupations other than the one in which they are engaged.

The interest profile of an accountant or of a man considering the accountancy profession should be compared with the median profile for 1,000 accountants as shown by the solid black line.

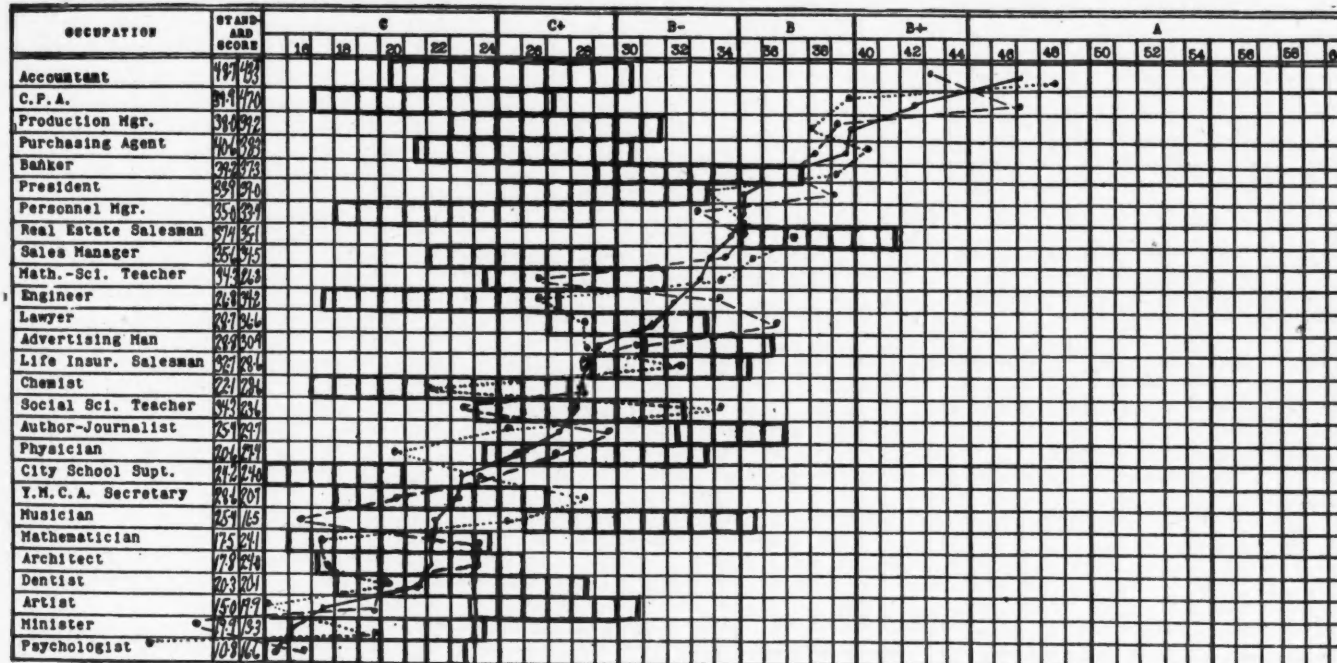
Men's interests change very little from 25 to 55 years of age. They change somewhat from 20 to 25 years and much more so from 15 to 20 years. Consequently, the younger the man, particularly below 20 years of age, the less certainly can his interests be identified in terms of some occupation. Such changes in interests as take place are more likely to result in higher ratings than the reverse.

The ratings from this test should not be viewed as conclusive; they are not guaranteed as correct. Instead they should be viewed as merely suggestive and to be considered in the light of all other information bearing upon one's vocational choice. Occupations rated A and B+ should be carefully considered before definitely deciding against them; occupations rated C, C+, and B— should be carefully considered before definitely deciding to enter them. Remember only a few from among all the hundreds of occupations are reported on here.

Median scores of 200 American junior accountants and 200 American partners with median scores for 1000 American public accountants.

EXHIBIT 2

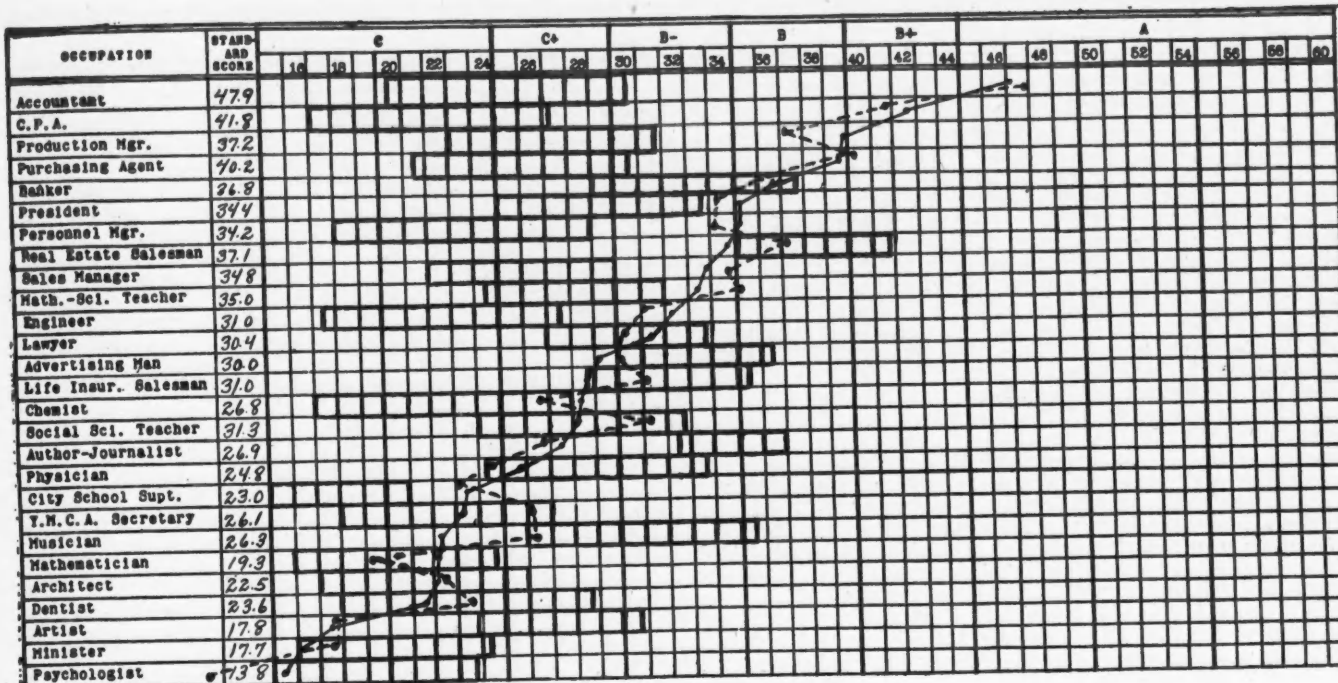
Median scores of 200 American junior accountants and 200 American partners with median scores for 1000 American public accountants.



* Partners
(See Exhibit 1 for general instructions.)
. . . . . 200 American junior accountants - - - - - 200 American partners
——— Median scores of 1000 Accountants (200 Partners, 200 Managers, 200 Seniors, 200 Semi-Seniors, 200 Juniors)

EXHIBIT 3

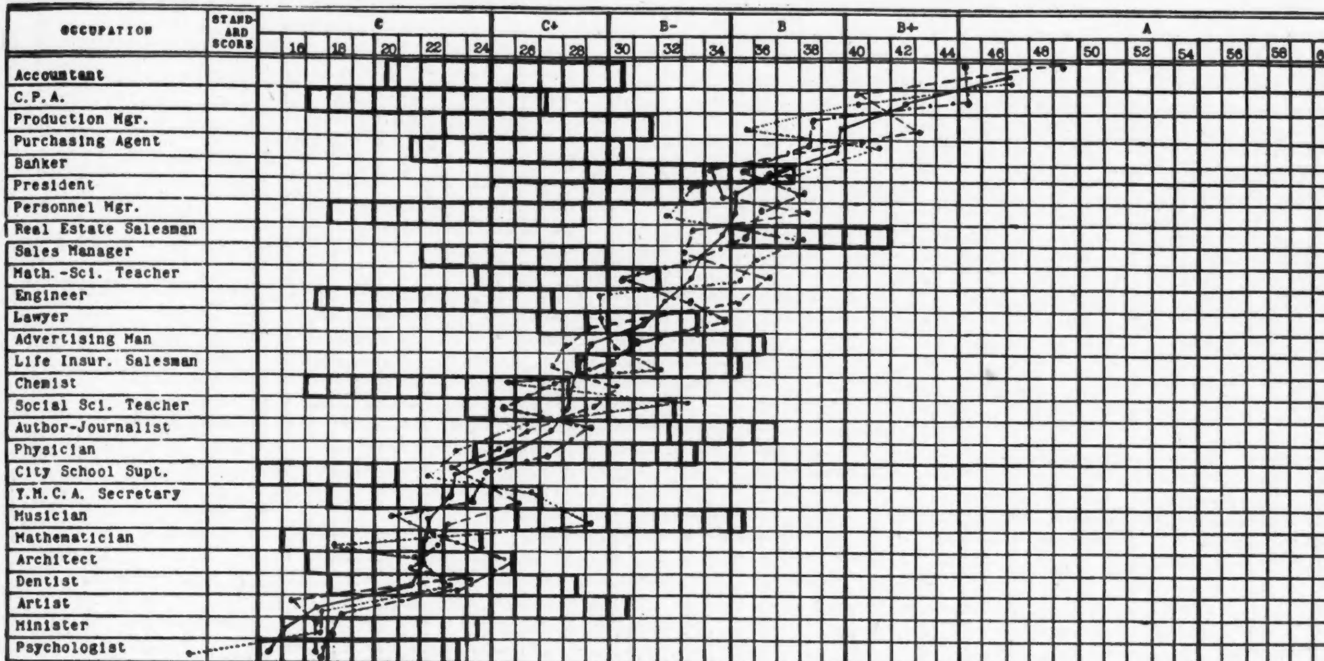
Median scores of 640 public accountants in Canada with median scores of 1000 public accountants in the United States.



(See Exhibit 1 for general instructions)
- - - - - Median scores of 640 accountants in Canada.
———— Median scores of 1000 accountants (200 Partners, 200 Managers 200 Seniors, 200 Semi-Seniors, 200 Juniors)

EXHIBIT 4

Median scores of 487 junior accountants, 72 senior accountants, 131 partners in Canada with median scores of 1000 public accountants in the United States.



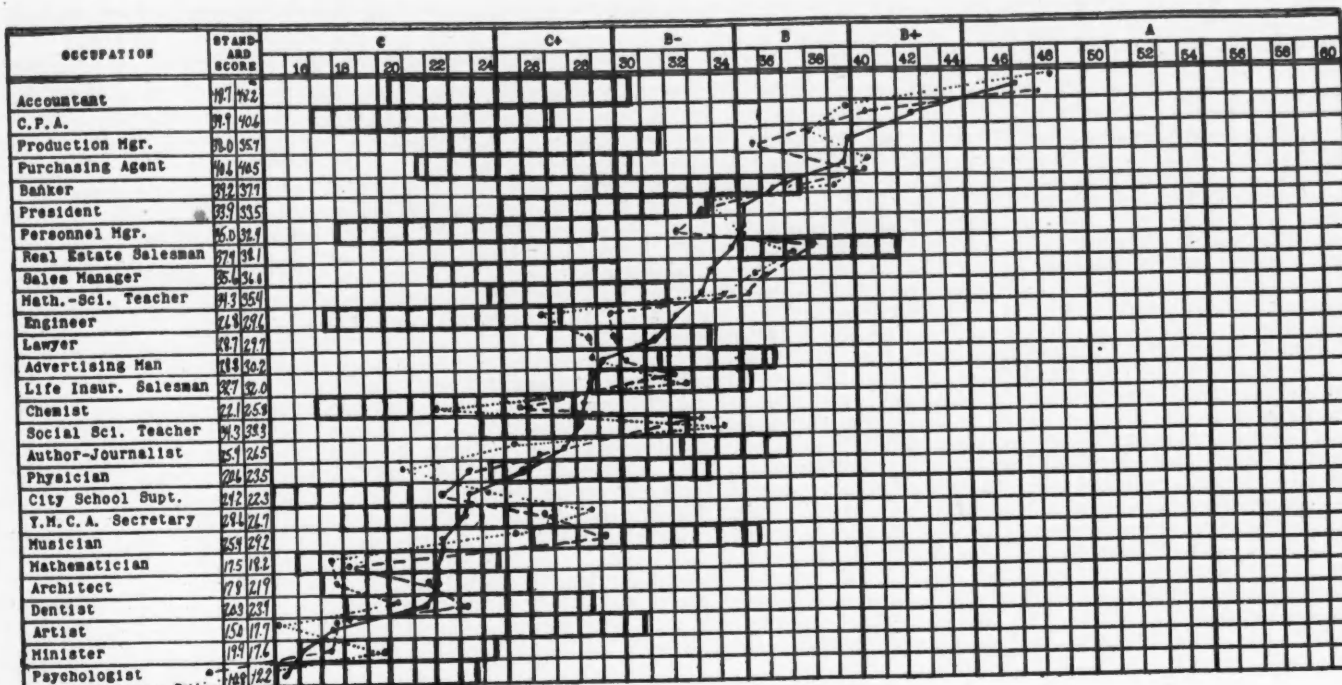
(See Exhibit 1 for general instructions.)

. . . . . . 487 Canadian junior accountants; . . . . . . 72 Canadian senior accountants —.—.—.—.— Canadian partners.

———Median scores of 1000 Accountants (200 Partners, 200 Managers, 200 Seniors, 200 Semi-Seniors, 200 Juniors)

EXHIBIT 5

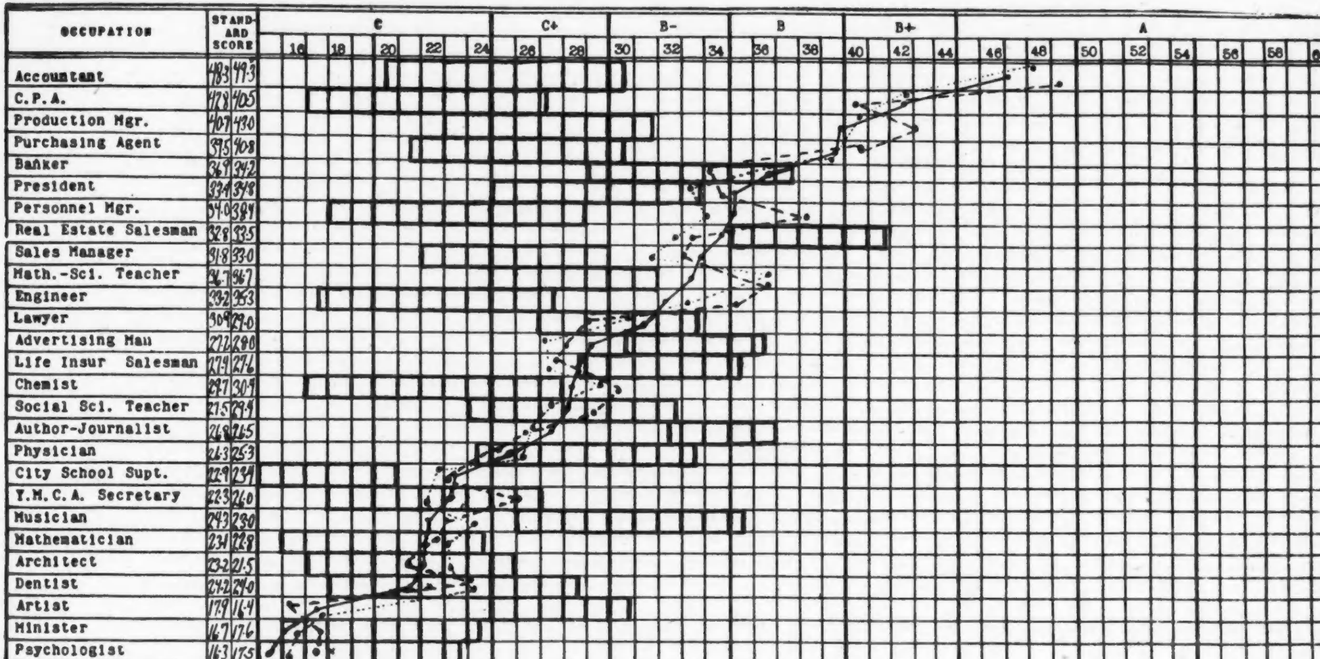
Median scores of 487 junior accountants in Canada with median scores of 200 junior accountants in the United States.



* Canadian Medians
(See Exhibit 1 for general instructions.)
- - - - - 487 Canadian junior accounts: . . . . . 200 American junior accountants
———— Median scores of 1000 Accountants (200 Partners, 200 Managers, 200 Seniors, 200 Semi-Seniors, 200 Juniors)

EXHIBIT 6

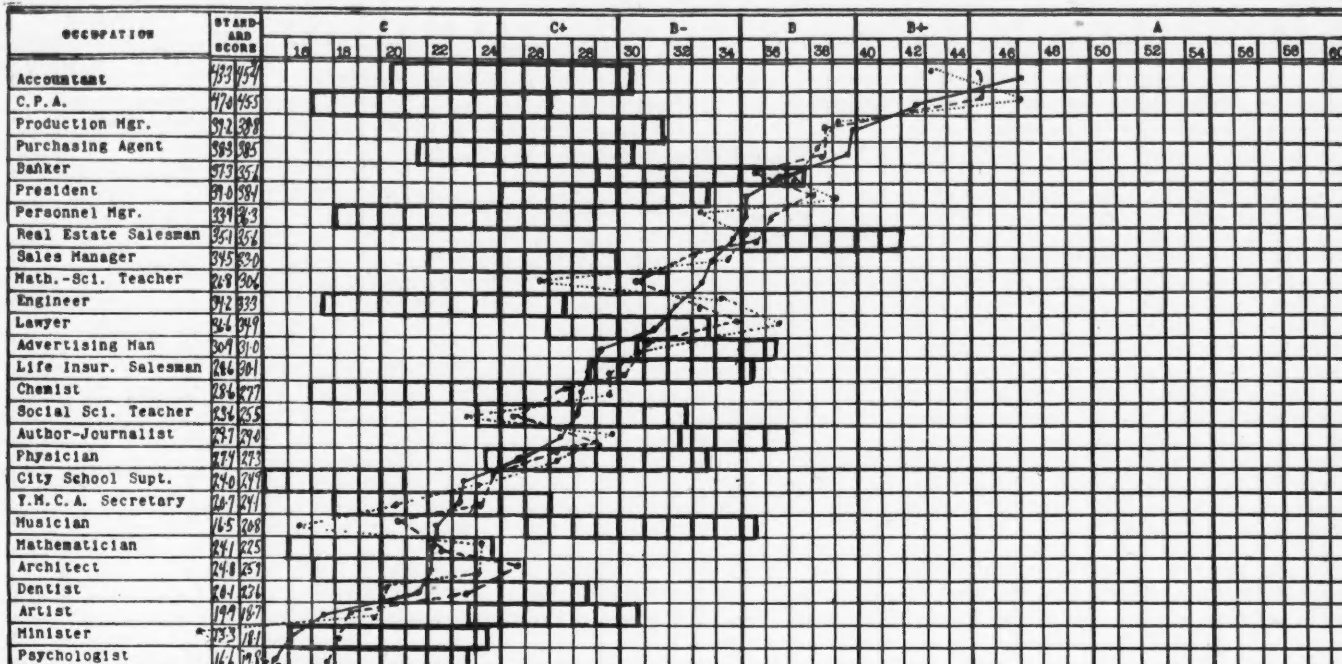
Median scores of 72 senior accountants in Canada with median scores of 200 senior accountants in the United States



* Canadian Medians
(See Exhibit 1 for general instructions.)
- - - - - 72 Canadian senior accountants; . . . . . 200 American senior accountants
———Median scores of 1000 Accountants (200 Partners, 200 Managers, 200 Seniors, 200 Semi-Seniors, 200 Juniors)

EXHIBIT 7

Median scores of 131 partners in Canada with median scores of 200 partners in the United States



* Canadian Medians
(See Exhibit 1 for general instructions.)
- - - - - 131 Canadian partners; . . . . . 200 American partners
———— Median scores of 1000 Accountants (200 Partners, 200 Managers, 200 Seniors, 200 Semi-Seniors, 200 Juniors)

EXHIBIT 8

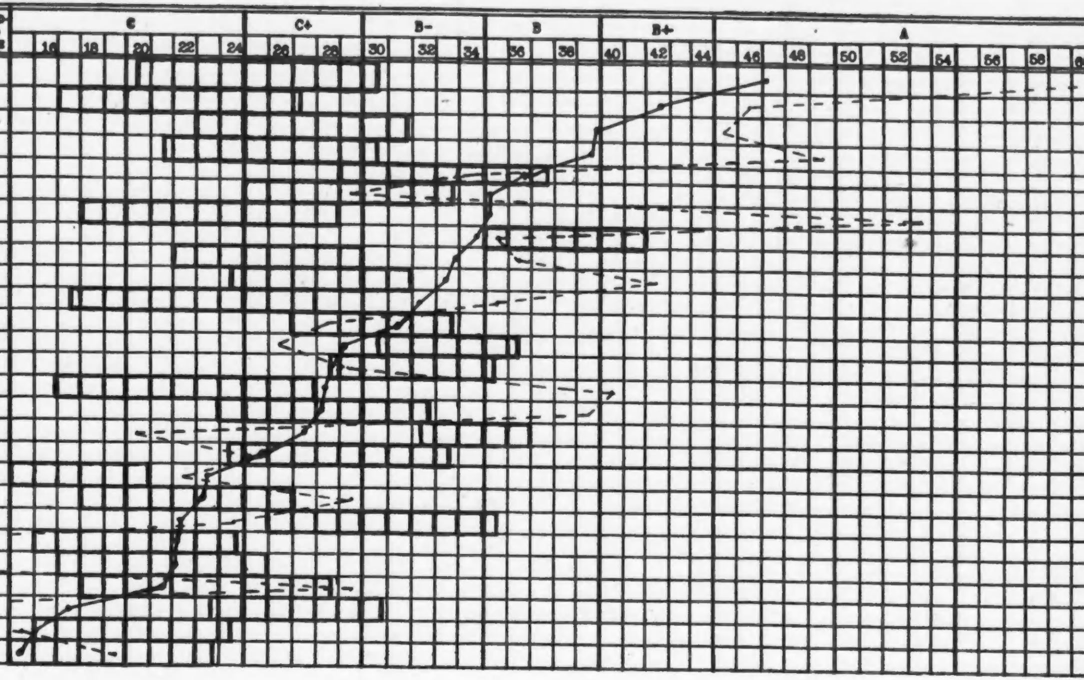
DISTRIBUTION OF SCORES OF PARTNERS, SENIOR, AND JUNIOR ACCOUNTANTS AMONG THE DIFFERENT LETTER RATINGS ON FIVE OCCUPATIONS

	C. P. A.			Accountant			Production Mgr.			President			Lawyer		
Rating	Partners	Seniors	Juniors	Partners	Seniors	Juniors	Partners	Seniors	Juniors	Partners	Seniors	Juniors	Partners	Seniors	Juniors
A	16	7	34	19	17	108	2	6	3	8	1	8	1		2
A	27	10	39	21	16	74	7	7	19	10	2	15	6	2	2
A	26	9	81	28	19	88	20	14	52	15	4	30	11	2	17
B+	32	11	74	22	6	65	29	18	79	17	17	66	21	4	27
B	10	16	77	16	8	54	30	13	84	34	11	66	26	11	78
B—	14	9	43	15	6	22	23	6	104	20	21	106	21	14	87
C+	5	7	38	7		17	13	6	62	17	12	71	26	17	92
C	1	3	46	3		8	6	2	33	9	4	62	16	21	121
Below C			5			1	1		1	1		13	3	1	11
Total	131	72	437	131	72	437	131	72	437	131	72	437	131	72	437

EXHIBIT 9

Name OLSON, GEORGE   Age 24   Date September 3, 1946

OCCUPATION	STANDARD SCORE
Accountant	62
C.P.A.	46
Production Mgr.	45
Purchasing Agent	49
Banker	34
President	29
Personnel Mgr.	53
Real Estate Salesman	35
Sales Manager	36
Math.-Sci. Teacher	42
Engineer	35
Lawyer	28
Advertising Man	26
Life Insur. Salesman	29
Chemist	40
Social Sci. Teacher	39
Author-Journalist	20
Physician	25
City School Supt.	22
Y.M.C.A. Secretary	29
Musician	24
Mathematician	10
Architect	12
Dentist	29
Artist	8
Minister	15
Psychologist	19

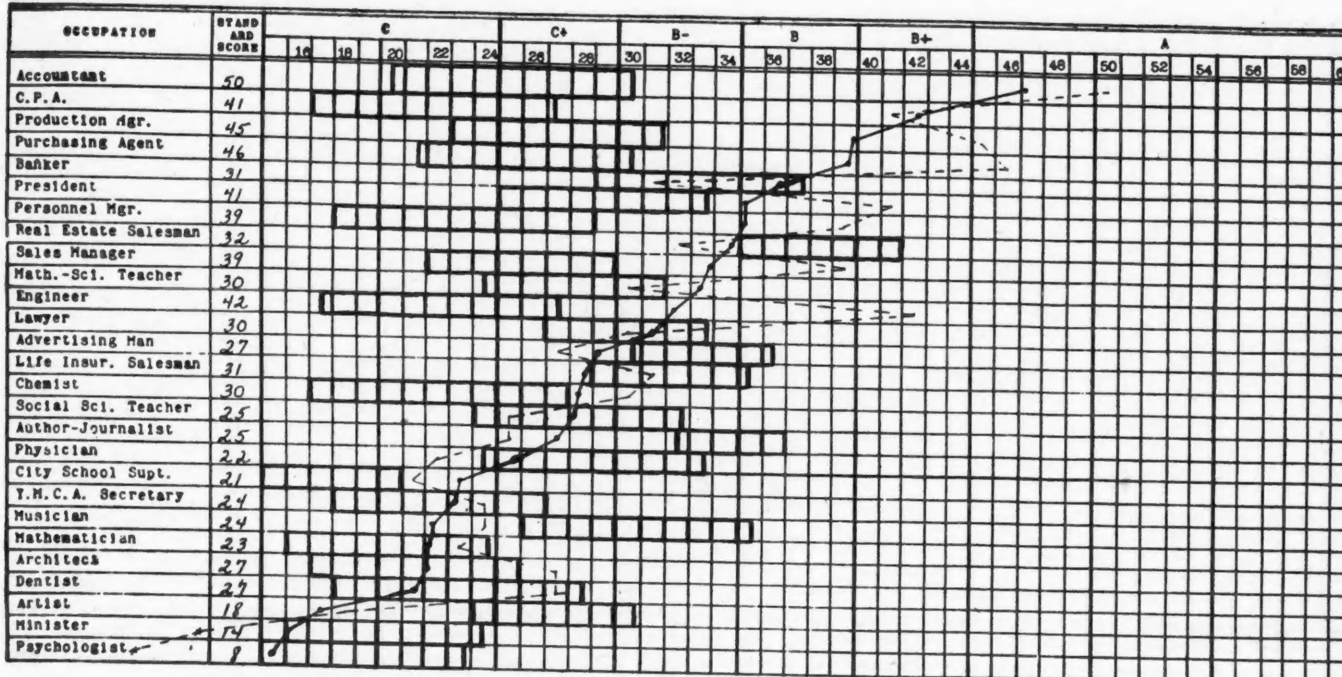


(See Exhibit 1 for general instructions)
———Median scores of 1000 Accountants (200 Partners, 200 Managers, 200 Seniors, 200 Semi-seniors, 200 Juniors)

EXHIBIT 10

Name BAKER, JOHN

Age 52 Date September 3, 1946



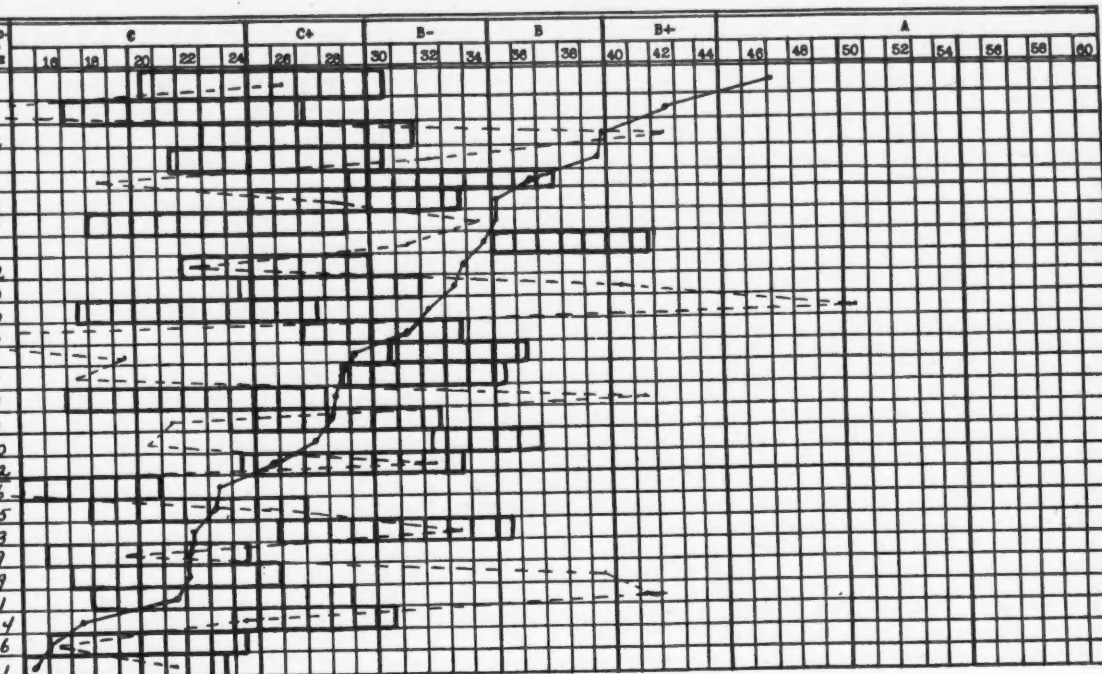
(See Exhibit 1 for general instructions)

———Median scores of 1000 Accountants (200 Partners, 200 Managers, 200 Seniors, 200 Semi-seniors, 200 Juniors)

EXHIBIT 11

Name MASTERS, FRANK   Age 27   Date September 3, 1946

OCCUPATION	STANDARD SCORE
Accountant	26
C.P.A.	10
Production Mgr.	42
Purchasing Agent	33
Banker	18
President	28
Personnel Mgr.	34
Real Estate Salesman	31
Sales Manager	22
Math.-Sci. Teacher	40
Engineer	50
Lawyer	10
Advertising Man	19
Life Insur. Salesman	17
Chemist	41
Social Sci. Teacher	21
Author-Journalist	20
Physician	32
City School Supt.	6
Y.M.C.A. Secretary	25
Musician	33
Mathematician	19
Architect	39
Dentist	41
Artist	24
Minister	16
Psychologist	21



(See Exhibit 1 for general instructions)
———Median scores of 1000 Accountants (200 Partners, 200 Managers, 200 Seniors, 200 Semi-seniors, 200 Juniors)

Book Reviews

Administrative Control by Kenneth J. Wharton, A.L. A.A., published in England by Gee and Company (Publishers) Limited, 27-28 Basinghall Street, London, EC 2, Post Free 15/6, 135 pages.

This is a useful review of the principles of Office Management and Organization involving an explanation of features of control which should exist in any large office organization. The author has provided suggestions covering scrutiny which might be made by an impartial investigator of the present office routine and direction with the purpose of developing faults, unnecessary operations and indirect waste effort. He discusses also matter of personnel selection, handling, training and incentives other than wage incentives.

Some Specialized Phases of Accounting Practise—(a) Contractors' Accounts and Accounting for the Extractive Industries, two texts by Myron M. Strain, C.P.A., Dean of Accountancy, Golden Gate College, San Francisco; (b) Brokerage Accounts by Floyd P. Karg, C.P.A., of Lybrand, Ross Bros. and Montgomery, Published in the U.S.A. by The Pacioli Press, San Francisco, 154 pages, price $5.00 U.S.

This volume contains three texts prepared for the use of graduate students of accountancy at Golden Gate College. The foreward remarks that, as admission to the graduate college is restricted to those applicants who have received a Bachelor's degree with a major in accountancy, elementary material is omitted. These studies are well done and the volume will be found to be an excellent addition to institute or firm libraries. It is probable that the discussion of Accounting for the Extractive Industries will be found to be the most useful of the three. This subject is dealt with in five chapters, the first covering points applicable to all extractive industries (i.e. lumbering, mining, petroleum and gas industries) the second and third covering mines and petroleum production, and the last two dealing with the lumber industry. A series of problems without solutions on each phase concerned are included as a special section at the end of the book: and specimen financial statements, questionnaires, forms etc., used in the brokerage business are provided in a separately bound supplement.

Production Costs and Estimates by Andrew Mitler, Fellow of the Institute of Cost and Work Accountants, published in England by Gee and Company (Publishers) Limited, 27-28 Basinghall Street, London, E.C. 2, Post Free 13/ 135 pages.

A concise outline of the principles of accounting for the various elements of cost entering into production. A number of specific problems which arise in cost accounting are discussed and the principles governing the treatment to the accorded are outlined. This book is not in any sense a production cost manual, but is rather a summary of the principles governing the maintenance of such records. A number of examinations are included covering the contents of the various chapters.

Practical Cost Accounts by Andrew Meller, Fellow of the Institute of Cost and Works Accounts ,published in England by Gee and Company (Publishers) Limited, 27-28 Basinghall Street, London, EC 2, Post Free 12/11d, 112 pages.

This book is a brief and rather elementary discussion of the function and nature of cost accounting and its application. The author points out a fact which is often overlooked, namely, that accounts and cost accounting can and should be used to assist in the elimination of waste but can only be successful if the person responsible for their operation is a trained accountant. The book sets out the general principles to be kept in mind in the operations of cost accountaing records and the accounting for the various cost elements, but does not illustrate the application of these principles by means of specimen entries and forms. A group of questions are included at the end of each chapter which would be useful for tutorial purposes, but the questions pre-suppose a knowledge of cost accounting beyond that covered by this work.

Income Tax Directive Number 8

Issued by the Deputy Minister (Taxation)
Department of National Revenue
April 25, 1947

ASSESSMENTS — DEDUCTIONS — MEMBERSHIP FEES

It has been the practice of this Department to allow, as deductions from business income, membership fees in Boards of Trade, Chambers of Commerce, Manufacturers' Associations, Credit Men's Associations, Commercial Travellers' Associations, and other similar trade or commercial associations formed for purposes of advancing the collective interests of any particular branch of a trade or commercial enterprise. The number of such associations has increased considerably in the past few years but, so long as the purposes and bona fides are clear, the fees are clearly legitimate expenditures made for the purpose of earning income.

Membership in engineering, scientific and other learned associations and societies clearly belong in the same category.

However, the deduction of these membership fees is permissible only in the case of entrepreneurs and is not allowable against the income of salaried persons. Any well-conducted organization which wishes to have members of its staff belong to such associations will readily arrange an additional membership subscription. Where the employer is not prepared to do so and the employee nevertheless feels that he ought to have a membership, no doubt he considers that this is worthwhile from the standpoint of his future advancement. The cost therefore becomes essentially a personal expense and is something which the individual should absorb out of his own income without expecting a Government contribution thereto by way of a tax concession.

Income Tax Directive Number 13

Issued by the Deputy Minister (Taxation)
Department of National Revenue
May 2, 1947.

ADMINISTRATION

Explanation of change in tax payable

Memorandum No. 60 (1944-45) is cancelled and is being re-written in order to stress the importance of sending an explanation to a taxpayer invariably when his own estimate of the tax payable is not acceptable to the Division

The rule is that in every case of an increase in the assessment over the amount calculated by the taxpayer, either a form T.7-W *must* accompany the form T.7 assessment notice or, if the explanation is short, that it be inserted in the form T.7 in the blank space provided for that purpose. No exception can be permitted because of size. A further tax of $2.50 may be as important to one taxpayer as a charge of $1,000 to another.

This will cause considerable additional work in the District Offices inasmuch as the number of taxpayers in Canada has increased enormously in recent years, but it is the duty of this Division, as well as our wish, to make sure that all taxpayers understand the reasons for which we find it necessary to call on them to pay more. After all, it is usually an unpleasant shock to the conscientious taxpayer when he gets a notice from us requiring a further payment. He is likely to be resentful in any event and to carry around his resentment for some time. He is certainly entitled to know *why* he was wrong in his own calculation.

It is important not only that the taxpayer should be given an explanation invariably but that it should be tactful, clear and well-reasoned. No off-hand, peremptory or sharp edged statement will meet the requirement. We are touching the taxpayer in a very sensitive spot and must be as careful and as decent as a doctor who has bad news for a patient. Here is one place where a knowledge of human relations is of importance in our work.

In the long view it is felt that doing this task well will decrease the work of the District Offices, inasmuch as it will help to indicate to taxpayers the proper method of

calculating their tax in future years, as well as gaining their co-operation.

Let us so organize our work as to ensure that we do not fail in a full observance of this rule hereafter.

Personals

Saul B. Marks, Chartered Accountant, announces the opening of an office for the practice of his profession at 64 King Street East, Hamilton, Ontario.

M. J. Prupas, Chartered Accountant, announces the removal of his offices to Suite 318, 10 St. James St. East, Montreal, Quebec.

William Brody, Chartered Accountant, announces the opening of an office for the practice of his profession at Suite 401, Ryrie Building, 229 Yonge Street, Toronto, Ontario.

Obituary

The Late Cecil Owen Taylor

The Institute of Chartered Accountants of Manitoba announces with regret the death of Mr. Cecil Owen Taylor on April 25, 1947.

Mr. Taylor was born in Winnipeg. He graduated from St. John's college in 1916, winning the Governor General's medal and became a member of the Institute of Chartered Accountants of Manitoba in 1924. He was western comptroller for the Lake of the Woods Milling Company and, at the time of his death, was engaged by the Audit Department of the Province of Manitoba.

To his wife and family, the Institute extends sincere sympathy.

The Late Austin Crawford Stead

The Institute of Chartered Accountants of Quebec regrets to announce the death at Montreal on 24th April 1947, after a prolonged illness, of Austin Crawford Stead, a former member of the firm of Riddell, Stead, Graham & Hutchison.

Mr. Stead was born in Montreal in 1874 and after leaving school entered the service of the Bank of Montreal in 1892. Ten years later, on leaving the Bank of Montreal, he joined the staff of Mr. A. F. Riddell, who had, on the death of Mr. Common, continued the practice and name of Riddell & Common. After passing the examinations prescribed, Mr. Stead was admitted a member of the Institute (then known as the Association of Accountants in Montreal) on 12th June 1905. In the same year he became a partner of Mr. Riddell, the firm name of Riddell & Common becoming Riddell & Stead.

He served as a member of the Council of the Association of Accountants in Montreal for some years and was Vice-President from 1911 to 1913.

Mr. Stead was intensely patriotic and his patriotism was never vocal—he preferred to express it in service. During the War of 1914-18 he was Secretary of the Khaki Club and for many years he was President of the Montreal Branch of the Navy League of Canada.

To his widow, son and two daughters, the Institute extends its sincere sympathy.

Current Accounting Literature

By Frank S. Capon, C.A.,
Montreal, P.Q.

Accounting During Inflation or Deflation

Special accounting problems come to the fore in times of inflation or deflation, and in view of the uncertainties surrounding present economic conditions, we would all be well advised to study the paper by Dean Perry Mason, published in the 1st April N.A.C.A. Bulletin. Dean Mason points out that dollar figures for sales, costs, and profits become distorted in periods of rapidly changing money values, and that balance sheet comparisons lose much of their meaning. At this time, accountants should not be content to insist on the bleak use of historical cost figures and plead lack of ability as valuers or appraisers as an excuse for producing valuable statements. Rather, they should take their place as interpreters for management, point out the inherent dangers of using distorted figures and comparisons, and by means of quantity figures or indices, endeavour to portray the physical accomplishments of business in order to show the true position.

Standard Costs

Using the cost system of a large textile plant as his example, W. E. Perry has contributed a complete and extremely well illustrated article on a post-war system of standard costs and budgetary control in the 1st April N.A. C.A. Bulletin. While the basic principles of the system discussed do not differ from most systems to any extent, the author has provided schedules showing account classifications, method of calculation of standards for various departments, analysis of variances, and budget sheets.

Cost Accounting's Role in Management

In the same bulletin, F. J. Carr has written an article

PUBLICATION ADDRESSES, AND PRICE PER COPY POSTPAID

Accountancy, Incorporated Accountants' Hall, Victoria Embankment, London, W.C. 2, England. 1 shilling.
Accountants' Magazine, 23 Rutland Square, Edinburgh, Scotland. 1s. 3d.
Accounting Review, School of Commerce, Northwestern University, Evanston, Ill., U.S.A. $1.
The Accountant, Moorgate Place, London E.C. 2, England. 1 shilling.
The Controller, 1 East 42nd St., New York, N.Y. 50 cents.
Cost and Management, 66 King St. East, Hamilton, Ont. 35 cents.
Harvard Business Review, Harvard University, Boston, Mass., U.S.A. $1.50.
Journal of Accountancy, 13 East 41st St., New York, N.Y. 35 cents.
The Internal Auditor, 39 Atlantic Street, Stamford, Conn., U.S.A. $1
National Association of Cost Accountants, 385 Madison Ave., New York. 75 cents.
Taxes—The Tax Magazine. CCH Canadian Limited, 31 Willcocks St., Toronto, Ont. $6.00 per year. (American Publication).

on the contribution made to management by cost accounting. The importance of this contribution cannot be overestimated, and accurate cost data is essential under really competitive conditions with which we shall shortly be faced. Business decisions must be based on sound facts if they are to be rational, and irrational business will not survive.

Valuation of Professional Business

Some of the special problems involved in the valuation of a professional practice are dealt with by J. H. Burton in the 29th March issue of "The Accountant". Goodwill is, of course, the only serious point at issue, and the method of valuation may vary depending upon whether the business is being sold, whether new partners are being admitted, the extent to which the value of the business is based on personal attributes of one or more partners, and so forth. Also, there are the alternative methods of valuation, such as net profit, gross fees, recurring fees, and 'super' profits.

Arbitration

The 22nd and 29th March issues of "The Accountant" contains a two-section article by Howard Button on the subject of arbitration. In view of the increasing extent to which arbitration is being resorted in various types of disputes, this article is timely, and deals both with the law and theory of arbitration as well as the actual procedure.

Audit Principles

As a follow up to Mr. Blair's earlier article on the need for clear audit principles, Professor A. C. Littleton has presented a very brief but important article in the April "Journal of Accountancy". Professor Littleton suggests three outstanding audit principles, which might be summarized as follows:

1. To allay doubts of the figure accuracy of statements.
2. To support the dependability of account classifications.
3. To substantiate representations made by management in financial statements.

While there may be many minor or subsidiary audit principles, these seem to be the three outstanding aims of the auditor. Professor Littleton scores a major point in his plea to train the audit student to think auditor's thoughts rather than to read in a set sequence what an auditor does.

Care of Records

Maintenance of old records or archives of business seems to be falling almost inevitably upon the shoulders of the accountant, and the importance of this task, also some of the complications, are outlined by J. B. Kaiser in the April issue of "The Journal of Accountancy". There is the question of statutory limitations, which differ from one province to another, the problem of personal desires on the retention of valuable or worthless documents, the need for weighing the cost of keeping many other points which have to be taken into account. This is just another thankless task that is a must for the business accountant to whom records are of such vital importance.

Control of Expenses by Cost Accounting

The April "Journal of Accountancy" contains another article on standard costs, this time by T. R. Hoside. Both the aims of standard cost systems and the procedure for establishing such systems are discussed briefly, and the author emphasizes that standard costs are an instrument of, and not a substitute for, management.

Current Business Problems

Two outstanding articles on current business problems, the first by C. T. Curtis on the subject of the U. S. taxation outlook, and the second by M. P. McNair on the readjustment outlook for 1947, are included in the April issue of "The Controller". From the tax viewpoint, we in Canada must of necessity keep a weather eye on U. S. developments, since our tax policies and structures are so closely parallel with those of our closest neighbour. As far as the general business outlook is concerned, our economy is inextricably interwoven with that of the U. S. and Mr. McNair's article might well be written of our own situation. Accountants will have much to do with situations resulting from the coming economic developments, even though they may be powerless to change the trends.

Incentive Wage Plans

There is probably room for a wage incentive plan in any business where labour costs are a significant part of the total manufacturing costs. One such plan, which has been successfully operated for over ten years, is explained by A. C. Croft in the April issue of "The Controller". In theory, a sound incentive plan will result in both reduced

unit wage costs and higher employee earnings, and the importance of such objectives cannot be overestimated at a time of almost irrestible pressure on wage rates and prices.

Professional Etiquette

It is probably not unfair to say that the vast majority of accountants never give any serious thought to the rules of etiquette of the profession—except when they come knowingly up against one of the rules. Because of the importance of the rules to all of us, we stand to gain by a review of the two-part article on professional etiquette by R. A. Witty, commencing in the April issue of "Accountancy". The article deals with such points as the displacement of one account by another, advertising, fee cutting, receipt or payment of commissions, certificates, handling of client's monies, evidence in court, basis of fees, new practitioners and ultimate aims of professional etiquette.

Statistical Presentation

Graphic or pictorial presentation of financial information is playing an ever-increasing part in industrial accounting. The March issue of "Cost and Management" contains an article by G. R. Munro on the use of statistics, types of financial charts, with a section dealing particularly with logarithmic charts.

Budgetary Control

In the March issue of "Cost and Management" there is an article by H. G. Riley on budgeting for profit. The author points out the use that management can make of dynamic statistics furnished by a flexible budget system. It is not sufficient, Mr. Riley states, to budget expenses—the entire operations should be controlled by a flexible budget, right down to the profit figure and actual results must be available in time for any necessary corrective action to be taken if forecasts are not being met.

STUDENTS' DEPARTMENT

J. E. Smyth, C.A., Editor

NOTES AND COMMENTS

When we read some of the published balance sheets of Canadian companies, only the traditional restraint of our profession prevents an emotional outburst, tears, and the like.

We have before us a recent balance sheet which, under the heading of "Capital Stock" (sic), presents two figures in addition to share capital: one for "Earned surplus", and another for "Profit and loss account". All the more surprising to find in the attached income statement that "Profit and loss account" enjoys an existence quite independent of "Earned surplus"; that it boasts an opening and closing balance all its own, and is credited with "net profit for the year" and is charged with dividends. And all the while not a word about what the management or auditors think "Earned surplus" is, where it came from, what it is supposed to do.

A question need not be less pertinent because it has been asked before: if accountants prepare or acquiesce in financial statements which even their fellow accountants cannot follow, what is a poor shareholder to make of it all?

Our view is that in the matter of balance sheet presentation text-book standards are embarrassingly in advance of practice. We have searched in vain for the "ideal" published balance sheet (but would welcome suggestions from any of our readers). Once we thought we had found one: it presented comparative figures, and was accompanied by an informative directors' report only to spoil everything by adding, on the right side of the balance sheet, the balance in "General reserve" to the balance in "Reserve for depreciation of buildings, machinery, and equipment" and producing (if you will pardon us) a totally meaningless figure!

Student's Association News

Quebec

On Tuesday, March 25th, 1947, the Chartered Accountants' Student Society of the Province of Quebec held the last in a series of four dinner meetings at the Queen's Hotel, Montreal. Mr. C. L. King, C.A., Secretary and Director of

Research of the Dominion Association of Chartered Accountants, was the guest speaker and delivered an interesting address on various aspects of accounting problems. Mr. King's address is published in this issue.

Ontario

At their annual meeting held May 12th in the theatre of the Royal Ontario Museum, Toronto, the Ontario Students' Association elected the following officers for the coming year: President: R. G. Aston, C.A.; Vice-President: A. G. Watson; Secretary: C. H. Tod; Treasurer: W. W. Evans; Members of Student Council: G. B. Donaldson, C.A., J. W. Bennett, B. H. Cook, W. K. Douglas, F. J. Lovett, R. D. Mackenzie.

The meeting was very well attended and all those present agreed that the evening was anything but dull. Following the usual business matters there was a lively discussion with representatives from the Department of Veterans' Affairs in connection with students' benefits from that Department. Also present was Professor Leonard of Queen's University who called upon the students for suggestions as to methods of conducting lectures to supplement the lesson material supplied with the course. Many worthwhile suggestions were received and these will receive immediate attention from the new council.

The guest speaker of the evening was Mr. J. C. Adams, K.C. His subject was Labour Relations, a very current and absorbing topic which, judging by the amount of interest shown by the students and the numerous requests to have him speak again in the near future, was very well received.

The evening was concluded with a skit depicting a typical day in a client's office, written and produced by the students. The play spared the feelings of no particular group and clients, chartered accountants and students were given many hearty laughs at their own shortcomings.

PROBLEMS AND SOLUTIONS

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and

explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

INTERMEDIATE EXAMINATION, DECEMBER 1946.

Accounting I, Question 2 (35 marks)

The following is the trial balance of Joe Measure, Civil Engineer as taken from his general ledger at 31st December 1944.

Accounts receivable	$15,700
Bank	10,500
Furniture & fixtures	1,250
General expenses	14,975
Interest	1,120
Investments in stocks & bonds	44,450
Beaver Dam project (Incomplete)	3,400
Real estate subdivision	7,000
	$98,395

Capital	$45,620
Bank loan	12,500
Central Construction Co.	6,000
Report No. 1—See Through Tunnel	4,800
Report No. 2—Hi-way Terminal	3,300
Report No. 3—Learn More Collegiate	4,100
Consulting fees	2,000
Mine Exploitation Company	1,800
Stocks & bonds	4,100
Report fees	14,050
Reserve for depreciation of furniture	125
	$98,395

On examining the accounts and questioning the bookkeeper the following information is obtained:

General Expenses include salaries Joe Measure—$5,500, other salaries—$7,400, rent—$900, printing, postage & stationery—$150, advertising—$550, telephone & telegraph—$75, donations—$100, travelling expenses—$200, other expenses—$100.

Central Construction Co. represents consulting fees received during the year 1944 on a monthly retaining basis.

Reports Nos. 1, 2, & 3 are fees on completed jobs.

Mine Exploitation Company represents $2,000 received on a contract commencing 1st October 1944 and $200 paid for consulting expenses in conjunction therewith. Under the terms of the contract Joe Measure is to act as consulting engineer for 9 months and receive $4,500 altogether.

Report Fees cover fees received under contract for report of which $8,000 was received on account of contracts not yet commenced. The balance represents finished work.

Stocks and Bonds is the profit on stock and bond transactions.

Additional information Dividends on stocks received during the year amounted to $2,200 of which $1,200 was applied to investment in stocks and bonds and $1,000 applied to stocks and bonds profit.

(Calculate depreciation on furniture at 10% per annum)

Required:

(a) Prepare the necessary journal entries to adjust the books in such a manner as to facilitate the drawing up of the required financial statements.
(b) Prepare revised trial balance.
(c) Prepare balance sheet as at 31st December 1944.
(d) Prepare income and expenditure statement (ignoring Income & Excess Profits tax) for year ended 31st December 1944.

SOLUTION

(a) *Adjusting Journal Entries*

1.	Drawings—Joe Measure	$ 5,500.00	
	Office Salaries	7,400.00	
	Rent	900.00	
	Printing, Postage & Stationery	150.00	
	Advertising	550.00	
	Telephone & Telegraph	75.00	
	Donations	100.00	
	Travelling Expenses	200.00	
	General Expenses		$14,875.00
2.	Central Construction Company	6,000.00	
	Consulting Fees		6,000.00
3.	Report No. 1 See Through Tunnel	4,800.00	
	Report No. 2 Hi-Way Terminal	3,300.00	
	Report No. 3 Learn More Collegiate	4,100.00	
	Report Fees		12,200.00
4.	Consulting Expense	200.00	
	Mine Exploitation Company		200.00
5.	Mine Exploitation Company	2,000.00	
	Consulting Fees		1,500.00
	Consulting Fees Unearned		500.00
6.	Report Fees	8,000.00	
	Report Fees unearned		8,000.00
7.	Investments in stocks and bonds	1,200.00	
	Dividend on stocks		1,200.00
8.	Stocks and bonds (profit)	1,000.00	
	Dividend on stocks		1,000.00
9.	Depreciation of furniture	125.00	
	Reserve for depreciation of furniture		125.00

(b) *Trial Balance*

DR.		*CR.*	
Accounts Receivable	$15,700.00	Capital	$45,620.00
Bank	10,500.00	Bank loan	12,500.00
Furniture & fixtures	1,250.00	Report fees	18,250.00
Drawings–Joe Measure	5,500.00	Consulting fees	9,500.00
Office salaries	7,400.00	Consulting fees unearned	500.00
Rent	900.00	Report fees unearned	8,000.00
Printing, postage & stationery	150.00	Dividends on stocks	2,200.00
Advertising	550.00	Profit on sale of stocks & bonds	3,100.00
Telephone & telegraph	75.00	Reserve for depreciation of furniture	250.00
Donations	100.00		
Travelling expenses	200.00		
General expense	100.00		
Interest	1,120.00		
Investment in stocks & bonds	45,650.00		

Beaver Dam project ..	3,400.00	
Real estate subdivision	7,000.00	
Depreciation of furniture	125.00	
Consulting expense ...	200.00	
	$99,920.00	$99,920.00

(c) *Balance Sheet*
as at 31st December, 1944

ASSETS

Current assets			
Cash in bank		$10,500.00	
Accounts receivable		15,700.00	
Work in progress—Beaver Dam project		3,400.00	
			$29,600.00
Investments—Stocks and bonds			45,650.00
Fixed assets			
Real estate—subdivision		7,000.00	
Furniture and fixtures	$ 1,250.00		
Less reserve for depreciation .	250.00		
		1,000.00	
			8,000.00
			$83,250.00

LIABILITIES AND PROPRIETORSHIP

Current liabilities		
Bank loan		$12,500.00
Deferred income		
Consulting fees unearned	$ 500.00	
Report fees unearned	8,000.00	
		8,500.00
Total liabilities		21,000.00
Capital account, Joe Measure		
Balance January 1, 1944	45,620.00	
Add Net income for year, per statement attached	22,130.00	
	67,750.00	
Deduct Drawings	5,500.00	
		62,250.00
		$83,250.00

(d) *Statement of Income and Expenditure*
for Year ended 31st December, 1944

Professional Earnings		
Consulting fees	$ 9,500.00	
Report fees	18,250.00	$27,750.00

Operating Expenditure		
Office salaries	$ 7,400.00	
Rent	900.00	
Advertising	550.00	
Travelling	200.00	
Consulting expense	200.00	
Printing, stationery & postage	150.00	
Telephone & Telegraph	75.00	
Donations	100.00	
Other expense	100,00	
Depreciation of furniture—10%	125.00	9,800.00
Net Professional Income		$17,950.00
Other Income		
Dividends on stocks	$ 2,200.00	
Profits on stocks and bonds sold	3,100.00	
	$ 5,300.00	
Less Interest expense	1,120.00	4,180.00
Net Income for year		$22,130.00

Editor's Notes

(a) Investment income (of all kinds) is $5,300 of which $2,200 is identified specifically as "dividends on stock". In the editor's opinion one would be entitled alternatively to regard the balance, $3,100, as interest on bond investments instead of profit on sale of investments.

(b) If the unearned fees were to be earned in the following year, the editor believes that they might be included under the heading "current liabilities", being the value of services paid for in advance by clients and owing to them within the next year.

PROBLEM II

FINAL EXAMINATION, DECEMBER 1946

Accounting II, Question 1, (5 marks)

"Costing technique is characterized by three amplifications of general accounting procedure."

What are these? (No detailed explanation required.)

SOLUTION

1. A more elaborate classification of outlays
2. The operation of perpetual or continuous records of inventories
3. The analysis of outlays by units of products.

PROBLEM III

FINAL EXAMINATION, DECEMBER 1946

Accounting II, Question 2 (5 marks)

In accounting for manufacturing costs, a company maintains a record of fixed and variable overhead expenses as well as a record of units produced.

Required:

(a) Distinguish between fixed and variable expenses by appropriate illustration.

(b) Explain the reason for maintaining a segregation of such expenses.

SOLUTION

Fixed expenses are those not likely to be affected by changes in production volume in a given accounting period; e.g., rent, depreciation, real estate taxes etc.

Variable expenses are those which are likely to increase or decrease with production volume; e.g., indirect labour, manufacturing supplies, etc.

The segregation of these two classes of overhead expenses makes possible an analysis of unit costs which is more meaningful than any analysis of changes in *total* average unit costs. The advantage in segregation arises out of the doubtful validity of watching a figure for unit costs which is obtained by dividing total costs (including fixed overhead expenses) by a number of units produced which will of course vary from one accounting period to the next.

PROBLEM IV

FINAL EXAMINATION, DECEMBER 1946

Accounting II, Question 3 (15 marks)

(a) Briefly distinguish between job costing and process costing.

(b) Classify the following under the headings "job (or special order) costing" and "process costing" according to the type of costing which would normally apply:

1. Flour mill.
2. Locomotive manufacturer.
3. Foundry.
4. Brewery.
5. Construction contractor.
6. Tea blender.
7. Bakery.
8. Yarn spinner.
9. Custom dyer.
10. Pulp and paper manufacturer.

(c) Name two instances from the above examples where standard costs could be used to advantage and explain why.

SOLUTION

(a) Job (or special order) costing consists of ascertaining the cost of individual items or groups of items produced.

Process costing entails ascertaining the cost of identical goods produced continuously over a period.

(b)

Job costing	*Process costing*
Locomotive manufacturer	Flour mill
Foundry	Brewery
Construction contractor	Tea blender
Custom dyer	Bakery
	Yarn spinner
	Pulp and paper manufacturer

(c) Yarn spinner
Pulp and paper manufacturer

These are industries where sufficient information should be available from the industry as a whole to provide standards with which actual costs may be compared. Further, the product manufactured in these instances would likely be uniform. A standard cost system would tend to be cumbersome where a wide variety of products are manufactured, or where products are custom-built.

The chief advantage of using standard costs is that they enable the manufacturer regularly to compare his actual costs with the theoretical cost under conditions of maximum efficiency.

Note: Others which could be chosen are: Flour mill; foundry.

DISCUSSION OF PROBLEM SOLUTION MARCH ISSUE, 1947

Regina, Saskatchewan,
April 4, 1947.

Dear sir,

I was interested to note that a solution given in the March 1947 issue reduced variances to a "per unit analysis".

It is my understanding that analyses of variances serve two purposes:

(a) Managerial—for information to executives as to the causes of variances

(b) Accounting—for disposition of variances in accounts.

The per unit figures may be of some interest re (a) but in view of the necessity of accounting treatment of variances re (b) I would imagine that an analysis in total dollar amounts would be of more significance.

The point I am attempting to bring out is not confined to this particular problem, but is the fact that the solution as reproduced makes one wonder whether, for examination purposes, one should attempt to treat these Cost Accounting problems as part of an operating cost accounting system of merely as an abstract situation with no relation to a going concern.

Yours very truly,
L. E. MANN.

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